

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-86556; File No. SR-NSCC-2019-002)

August 2, 2019

Self-Regulatory Organizations; National Securities Clearing Corporation; Notice of Filing of a Proposed Rule Change to Amend Procedure VII with Respect to the Receipt of CNS Securities and Make Other Changes

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on July 22, 2019, National Securities Clearing Corporation (“NSCC”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II and III below, which Items have been prepared by the clearing agency. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Clearing Agency’s Statement of the Terms of Substance of the Proposed Rule Change

The proposed rule change would amend Procedure VII of NSCC’s Rules & Procedures (“Rules”)<sup>3</sup> with respect to the receipt of securities from NSCC’s Continuous Net Settlement (“CNS”) System<sup>4</sup> and make technical changes, as described in greater detail below.

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> Capitalized terms not defined herein are defined in the Rules, available at [http://www.dtcc.com/~media/Files/Downloads/legal/rules/nscc\\_rules.pdf](http://www.dtcc.com/~media/Files/Downloads/legal/rules/nscc_rules.pdf).

<sup>4</sup> The CNS System and its operation are described in Rule 11 (CNS System) and Procedure VII (CNS Accounting Operation) of the Rules. Id.

II. Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the clearing agency included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The clearing agency has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

(A) Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

The purpose of this proposed rule change is to amend Procedure VII (CNS Accounting Operation) with respect to the receipt of securities from the CNS System in order to reflect a change in the allocation algorithm used during the night cycle.<sup>5</sup> The proposed rule change would also make technical changes.

**(i) BACKGROUND**

NSCC's CNS System is an automated accounting and securities settlement system that centralizes and nets the settlement of compared and recorded securities transactions and maintains an orderly flow of security and money balances. The CNS System provides clearance for equities, corporate bonds, unit investment trusts, and municipal bonds that are eligible for book-entry transfer at The Depository Trust Company ("DTC"), an NSCC affiliate.

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<sup>5</sup> Night cycle is sometimes also referred to as "evening cycle" in the Rules. To ensure consistent terminology usage, NSCC is proposing technical changes to replace references to "evening cycle" with "night cycle" as described in greater detail below.

Under the CNS System, all eligible compared and recorded transactions for a particular settlement date are netted by CUSIP<sup>6</sup> number into one position per Member. The position can be net long (buy), net short (sell) or flat. As a continuous net system, those positions are further netted with positions of the same CUSIP number that remain open after their original scheduled settlement date (usually two business days after the trade date or T+2), so that transactions scheduled to settle on any day are netted with fail positions (i.e., positions that have failed in delivery or receipt on the settlement date), which results in a single deliver or receive obligation for each Member for each CUSIP number in which the Member has activity.

CNS relies on an interface with DTC for the book-entry movement of securities. Procedure VII (CNS Accounting Operation) describes the receipt and delivery of CNS Securities. CNS short positions are compared against Members' DTC accounts to determine availability of securities for delivery. If securities are available, they are transferred from the Member's account at DTC to NSCC's account at DTC to cover the Member's short obligations to CNS. In contrast, the allocation of CNS long positions to receiving Members is processed in an order determined by an algorithm built into the system. CNS long positions are allocated to Members as the securities are received by NSCC, i.e., CNS long positions are transferred from the NSCC account at DTC to the accounts of NSCC Members at DTC, in accordance with the algorithm.

For CNS Securities, NSCC uses a modified delivery versus payment mechanism in that when a Member delivers securities to CNS, the Member receives a credit, and

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<sup>6</sup> CUSIP is a registered trademark of the American Bankers Association. The term "CUSIP number" refers to the Committee on Uniform Securities Identification Procedures identifying number.

when NSCC delivers securities to the long receiving Member (a long allocation), the securities deliveries/movements are not final until the “effective time” occurs pursuant to Rule 12 (Settlement).<sup>7</sup> Specifically, under the Rules, a CNS delivery transaction is complete and final as to the delivering Member once the securities are debited from the delivering Member’s account at DTC and credited to NSCC’s CNS account at DTC; however, a CNS delivery transaction does not become final as to the receiving “long” Member until the “effective time.”

The current settlement processing cycle spans two business days, with a night cycle that begins at approximately 8:30 p.m. Eastern Time (“ET”) on the day prior to settlement date and runs until approximately 10 p.m. ET, and a day cycle that begins at approximately 6:30 a.m. ET on settlement date and runs until approximately 3:10 p.m. ET. The night cycle and the day cycle settlement processes are essentially the same, except that the night cycle settlement process runs in batches and the day cycle settlement process runs continuously. Transactions that do not get processed for settlement during the night cycle are carried into the following day cycle for settlement processing.

#### *Current Allocation Algorithm*

NSCC employs an algorithm to determine the order in which Members with long allocations receive positions from CNS; however, Members can submit priority requests

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<sup>7</sup> Pursuant to Rule 12 (Settlement), the “effective time” generally occurs when it is clear that NSCC has either been paid, or is in a credit position with respect to a Member or its Settling Bank, and NSCC has no obligation due with respect to a Member pursuant to the Clearing Agency Cross-Guaranty Agreement. Until the effective time has occurred in accordance with the Rules, NSCC retains ownership rights in the long allocations. Supra note 3.

that override NSCC's algorithm when they have special needs to receive securities owed to them (e.g., the security is undergoing a corporate action or the Member has an urgent customer delivery). The priority requests can be submitted for the night cycle, the day cycle, or both.

Pursuant to Procedure VII, subsection E (Influencing Receipts from CNS), Members can request that they receive priority for some or all issues on a standing or override basis. NSCC's Rules also permit a Member to buy-in long positions that have not been delivered to it by the close of business on the scheduled settlement date. Submission of buy-in notices and other specified activity will also affect the priority of a Member's long position.

The current priority groups are as follows –

First, long positions in a CNS Reorganization Sub-Account established pursuant to paragraph H.4 of Procedure VII of the Rules;<sup>8</sup>

Second, long positions against which Buy-In Intent<sup>9</sup> notices are due to expire that day but which were not filled the previous day;

Third, long positions against which Buy-In Intent<sup>10</sup> notices are due to expire the following day;

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<sup>8</sup> Supra note 3.

<sup>9</sup> Section 7 of Rule 11 (CNS System) and subsection J of Procedure VII (CNS Accounting Operation) of the Rules provide that in the event a Member has a Long Position in a CNS Security, the Member may demand immediate delivery thereof by submitting to NSCC a Buy-In Intent notice in such form and within such times as determined by NSCC. Supra note 3.

<sup>10</sup> Id.

Fourth, (i) long positions in a receiving ID Net Subscriber’s agency account established at a Qualified Securities Depository,<sup>11</sup> and (ii) long positions against the component securities of index receipts;

Fifth, in descending sequence, priority levels as specified by Standing Priority Requests and as modified by Priority Overrides.

Currently, when more than one long position in a given CNS Security exists within the same priority group, the positions are allocated based on their age, i.e., the “oldest” position is allocated first.<sup>12</sup> In addition, when more than one long position in a given CNS Security exists within the same priority group all of which have been long the same number of consecutive days (i.e., within the same age group), the allocation rank is determined by a computer generated random number.

The allocation algorithm currently used for the night and day cycles is the same but is computed separately.

**(ii) PROPOSED CHANGES TO ALLOCATION ALGORITHM**

NSCC, together with DTC,<sup>13</sup> is looking to improve processing efficiency and maximize the number of securities transactions processed for settlement during the night cycle.

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<sup>11</sup> ID Net Service and its operation are described in Rule 65 (ID Net Service) and Procedure XVI (ID Net Service) of the Rules. Supra note 3.

<sup>12</sup> Age is defined in Procedure VII, subsection E, as the number of consecutive days during which the position has been long, irrespective of quantity. Supra note 3.

<sup>13</sup> On July 22, 2019, DTC submitted a proposed rule change to implement a new algorithm to optimize its settlement processing of transactions during the night cycle (“DTC settlement optimization algorithm”). The proposal is designed to maximize the number of transactions processed for settlement during the night cycle. See SR-DTC-2019-005, which was filed with the Commission. A copy of

Currently, approximately 50 percent (50%) of the CNS transactions are processed for settlement during the night cycle. In order to improve processing efficiency and maximize the number of CNS transactions that would get processed for settlement during the night cycle, NSCC is proposing a modification to the allocation algorithm used during the night cycle. NSCC anticipates that the proposal would increase the percentage of CNS transactions processed for settlement during the night cycle to approximately 65 percent (65%).

As described above, the current allocation sequence for day cycle and night cycle is as follows: priority groups, age of positions, and random number within an age group. Under the proposal, NSCC is proposing changes to the allocation algorithm so that age of positions and random number within an age group would no longer be considered as factors when allocating CNS long positions within the same priority group during the night cycle.<sup>14</sup> Instead, allocation of CNS long positions within the same priority group during the night cycle would be determined by the DTC settlement optimization algorithm.<sup>15</sup>

NSCC believes eliminating the age of positions and random number within an age group from being considered as factors when allocating CNS long positions within the same priority group during the night cycle would help maximize the number of

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the proposed rule change is available at <http://www.dtcc.com/legal/sec-rule-filings.aspx>.

<sup>14</sup> Based on data from January through April 2019, aged positions (i.e., positions that have failed in delivery or receipt on their respective scheduled settlement dates for one or more days) comprised approximately 0.21 percent of the value of all transactions received before netting.

<sup>15</sup> Supra note 13.

transactions processed for settlement during the night cycle. Specifically, removing the requirement to process transactions for settlement during the night cycle in an order based on the age of positions and random number within an age group would help the DTC settlement optimization algorithm<sup>16</sup> perform more effectively in identifying the optimal order by which transactions are processed for settlement, which in turn would help maximize the number of transactions processed for settlement during the night cycle.

NSCC is not proposing changes to the allocation algorithm used during the day cycle.

### **(iii) PROPOSED RULE CHANGES**

NSCC is proposing to add a clause to subsection C.4 of Procedure VII (CNS Accounting Operation) to make it clear that there would be differences in the allocation algorithm used for receipts from CNS between the day cycle and the night cycle processes. NSCC is also proposing to add a parenthetical regarding subsection E of Procedure VII for ease of reference.

In order to reflect the proposed elimination of random number within an age group as a factor when allocating CNS long positions within the same priority group during the night cycle, NSCC is proposing to modify the first paragraph of subsection E of Procedure VII by deleting the references to an algorithm which changes daily.

NSCC is also proposing to revise subsection E.4 of Procedure VII to reflect the proposed changes to the allocation algorithm used during the night cycle by adding (i) “and, for the day cycle only,” to the first paragraph in subsection E.4 and (ii) “For the

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<sup>16</sup> Id.

day cycle only,” to the third and fourth paragraphs of subsection E.4. These changes are being proposed in order to make it clear that age of positions and random number within an age group would only be considered as factors when allocating CNS long positions during the day cycle.

In addition, NSCC is proposing to modify the last paragraph of subsection E.4 of Procedure VII to make it clear that the allocation algorithm used for the night and day cycles is computed separately to allow for the use of different allocation factors in those respective cycles.

NSCC is proposing technical changes by replacing references to “evening cycle” with “night cycle” in subsections A, C.3, E.1, E.2, E.4, E.5, and H.5 of Procedure VII. Similarly, NSCC is proposing to replace references to (i) “evening allocation” with “night allocation” in subsections C.3, C.4, and J.1 of Procedure VII, (ii) “evening and day delivery cycles” with “night and day delivery cycles” in subsection E.4 of Procedure VII and (iii) “evening allocation cycle” with “night cycle” in Section I of Addendum G. These changes are being proposed to ensure consistency in terminology usage in the Rules. NSCC is also proposing technical changes to correct cross references in subsections E.3 and E.4(a) of Procedure VII.

#### **(iv) MEMBER OUTREACH**

Beginning in March 2018, NSCC has conducted ongoing outreach with Members in order to provide them with notice of the proposed changes. As of the date of this filing, no written comments relating to the proposed changes have been received in response to this outreach. The Commission will be notified of any written comments received.

**(v) IMPLEMENTATION TIMEFRAME**

Pending Commission approval, NSCC expects to implement this proposal by September 26, 2019 and would announce the effective date of the proposed change by an Important Notice posted to its website. As proposed, a legend would be added to Procedure VII and Addendum G stating there are changes that have been approved by the Commission but have not yet been implemented. Each proposed legend also would include a date by which such changes would be implemented and the file number of this proposal, and state that, once this proposal is implemented, the legend would automatically be removed from Procedure VII and Addendum G, as applicable.

2. Statutory Basis

NSCC believes this proposal is consistent with the requirements of the Act, and the rules and regulations thereunder applicable to a registered clearing agency. Specifically, NSCC believes this proposal is consistent with Section 17A(b)(3)(F)<sup>17</sup> of the Act for the reasons described below.

Section 17A(b)(3)(F) of the Act requires, in part, that the Rules be designed to promote the prompt and accurate clearance and settlement of securities transactions.<sup>18</sup> NSCC believes that the proposed changes to the allocation algorithm used during the night cycle would promote prompt and accurate clearance and settlement of securities transactions. This is because the proposed changes would remove the requirement to process transactions for settlement during the night cycle in an order based on the age of positions and random number within an age group. Eliminating the requirement to

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<sup>17</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>18</sup> Id.

process transactions in an order based on the age of positions and random number within an age group would help enhance the effectiveness of the DTC settlement optimization algorithm in identifying the optimal order to process transactions for settlement. Being able to effectively identify the optimal order to process transactions for settlement would help maximize the number of transactions processed for settlement during the night cycle. Therefore, NSCC believes that the proposed changes to the allocation algorithm used during the night cycle would promote the prompt and accurate clearance and settlement of securities transactions, consistent with Section 17A(b)(3)(F) of the Act.

NSCC also believes that the proposal to make technical changes would promote prompt and accurate clearance and settlement of securities transactions. This is because the proposed technical changes would help ensure consistency in terminology usage and correct cross references in the Rules, both of which would ensure the Rules are clear and accurate. Having clear and accurate Rules would help Members to better understand their rights and obligations regarding NSCC's clearance and settlement services. NSCC believes that when Members better understand their rights and obligations regarding NSCC's clearance and settlement services, they can act in accordance with the Rules. NSCC believes that better enabling Members to comply with the Rules would promote the prompt and accurate clearance and settlement of securities transactions by NSCC. As such, NSCC believes the proposal to make technical changes is consistent with Section 17A(b)(3)(F) of the Act.<sup>19</sup>

(B) Clearing Agency's Statement on Burden on Competition

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<sup>19</sup> Id.

NSCC believes the proposed changes to the allocation algorithm used during the night cycle could burden competition. This is because by eliminating the age of positions and random number within an age group from being considered as factors when allocating CNS long positions during the night cycle, Members with the oldest positions would no longer receive priority during the night cycle. While Members with aged positions would no longer be prioritized over other Members within the same priority group, NSCC does not believe such change in priority would in and of itself mean that the burden on competition is significant. This is because, as described above, aged positions only comprised approximately 0.21 percent of the value of all transactions received before netting. Accordingly, NSCC does not believe the burden on competition would be significant.

Regardless of whether the burden on competition is deemed significant, NSCC believes any burden on competition that is created by these proposed changes would be necessary and appropriate in furtherance of the purposes of the Act, as permitted by Section 17A(b)(3)(I) of the Act.<sup>20</sup>

The proposed changes to the allocation algorithm used during the night cycle would be necessary in furtherance of the purposes of the Act because the Rules must be designed to promote the prompt and accurate clearance and settlement of securities transactions.<sup>21</sup> As described above, NSCC believes that the proposed changes would promote the prompt and accurate clearance and settlement of securities transactions by maximizing the number of transactions processed for settlement during the night cycle.

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<sup>20</sup> 15 U.S.C. 78q-1(b)(3)(I).

<sup>21</sup> 15 U.S.C. 78q-1(b)(3)(F).

As such, NSCC believes these proposed changes would be necessary in furtherance of the purposes of the Act, as permitted by Section 17A(b)(3)(I) of the Act.<sup>22</sup>

NSCC believes any burden on competition that is created by the proposed changes to the allocation algorithm used during the night cycle would also be appropriate in furtherance of the purposes of the Act. The proposed changes would eliminate the age of positions and random number within an age group from being considered as factors when allocating CNS long positions within the same priority group during the night cycle, which would in turn enhance the effectiveness of the DTC settlement optimization algorithm in identifying the optimal order by which to process transactions for settlement during the night cycle. Being able to effectively identify the optimal order by which to process transactions for settlement during the night cycle would in turn help maximize the number of transactions processed for settlement during the night cycle. As such, NSCC believes these proposed changes would be appropriate in furtherance of the purposes of the Act, as permitted by Section 17A(b)(3)(I) of the Act.<sup>23</sup>

NSCC does not believe the proposal to make technical changes would impact competition. These changes are being proposed to ensure consistency in terminology usage in the Rules and to correct cross references. They would not change NSCC's current practices or affect Members' rights and obligations. As such, NSCC believes the proposal to make technical changes would not have any impact on competition.

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<sup>22</sup> 15 U.S.C. 78q-1(b)(3)(I).

<sup>23</sup> Id.

(C) Clearing Agency's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments relating to this proposed rule change have not been solicited or received. NSCC will notify the Commission of any written comments received by NSCC.

III. Date of Effectiveness of the Proposed Rule Change, and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period up to 90 days (i) as the Commission may designate if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- (A) by order approve or disapprove such proposed rule change, or
- (B) institute proceedings to determine whether the proposed rule change

should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NSCC-2019-002 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

All submissions should refer to File Number SR-NSCC-2019-002. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of NSCC and on DTCC's website (<http://dtcc.com/legal/sec-rule-filings.aspx>). All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make

available publicly. All submissions should refer to File Number SR-NSCC-2019-002 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>24</sup>

Jill M. Peterson  
Assistant Secretary

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<sup>24</sup> 17 CFR 200.30-3(a)(12).